

Internal Revenue Service, Treasury

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section 1293 of the undistributed earnings as defined in paragraph (b)(3) of this section.

Example: The facts are the same as in §1.1294-1T (b)(3), *Example 1*, with the following exceptions. *S*, a domestic corporation, did not dispose of any *FC* stock in 1987. Therefore, because *S* held 50 percent of the *FC* stock throughout 1987, *S*'s pro rata share of *FC*'s ordinary earnings was \$50,000*x*. In addition to \$50,000*x* of ordinary earnings from *FC*, *S* had \$12,500*x* of domestic source income and \$6,000*x* of expenses (other than interest expense) not definitely related to any gross income. These expenses are apportioned, pursuant to §1.861-8(c)(2), on a pro rata basis between the domestic and foreign source income—\$1,200*x* of expenses, or one-fifth, to domestic source income, and \$4,800*x* of expenses, or four-fifths, to the section 1293 inclusion. *FC* paid foreign taxes of \$25,000*x* in 1987. Accordingly, *S* is entitled to claim as an indirect foreign tax credit pursuant to section 1293(f) a proportionate amount of the foreign taxes paid by *FC*, which is \$12,500*x* (\$25,000*x* × \$50,000*x*/\$100,000*x*). *S* is taxed in the U.S. at the rate of 34 percent. The amount of tax liability for which *S* may extend the time for payment is determined as follows:

1987 TAX LIABILITY (WITH SECTION 1293 INCLUSION)

Source	U.S.	Foreign
Income	12,500 <i>x</i>	0
Section 1293	0	50,000 <i>x</i>
Expenses	– 1,200 <i>x</i>	– 4,800 <i>x</i>
Taxable income	11,300 <i>x</i>	45,200 <i>x</i>
Total taxable income	56,500 <i>x</i>	
U.S. income tax rate	x34%	
Pre-credit U.S. tax	19,210 <i>x</i>	
Foreign tax credit	– 12,500 <i>x</i>	
1987 Tax Liability	6,710 <i>x</i>	

1987 TAX LIABILITY (WITHOUT SECTION 1293 INCLUSION)

Source	U.S.	Foreign
Income	12,500 <i>x</i>	0
Expenses	– 6,000 <i>x</i>	
Taxable income	6,500 <i>x</i>	
U.S. tax rate	x34%	
U.S. Tax	2,210 <i>x</i>	
Foreign tax credit	0	
Hypothetical 1987 Tax Liability	2,210 <i>x</i>	

The amount of tax, payment of which *S* may defer pursuant to section 1294, is \$4,500*x* (\$6,710*x* less \$2,210*x*).

(g) *Authority to require a bond.* Pursuant to the authority granted in section 6165 and in the manner provided therein, and subject to notification, the District Director may require the electing shareholder to furnish a bond to secure payment of the tax, the time for payment of which is extended under this section. If the electing shareholder does not furnish the bond within 60 days after receiving a request from the District Director, the election will be revoked.

(h) *Annual reporting requirement.* The electing shareholder must attach Form 8621 or a statement to its income tax return for each year during which an election under this section is outstanding. The statement must contain the following information:

(1) The total amount of undistributed earnings as of the end of the taxable year to which the outstanding elections apply;

(2) The total amount of the undistributed PFIC earnings tax liability and accrued interest charge as of the end of the year;

(3) The total amount of distributions received during the taxable year; and

(4) A description of the occurrence of any other termination event described in paragraph (e) of this section that occurred during the taxable year.

The electing shareholder also shall file by the due date, as extended, for its return a copy of Form 8621 or the statement with the Philadelphia Service Center, P.O. Box 21086, Philadelphia, Pennsylvania 19114.

[T.D. 8178, 53 FR 6773, Mar. 2, 1988; 53 FR 11731, Apr. 8, 1988]

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[T.D. 8750, 63 FR 14, Jan. 2, 1998, as amended by T.D. 8870, 65 FR 5779, Feb. 7, 2000; 65 FR 16319, Mar. 28, 2000; T.D. 9123, 69 FR 24073, May 3, 2004]

§ 1.1295-1 Qualified electing funds.

- (a) *In general.* [Reserved]
- (b) *Application of section 1295 election.* [Reserved]
 - (1) *Election personal to shareholder.* [Reserved]
 - (2) *Election applicable to specific corporation only—*
 - (i) *In general.* [Reserved]
 - (ii) *Stock of QEF received in a non-recognition transfer.* [Reserved]
 - (iii) *Exception for options.* A shareholder's section 1295 election does not

apply to any option to buy stock of the PFIC.

(3) *Application of general rules to stock held by a pass through entity—*(i) *Stock subject to a section 1295 election transferred to a pass through entity.* A shareholder's section 1295 election will not apply to a domestic pass through entity to which the shareholder transfers stock subject to section 1295 election, or to any other U.S. person that is an interest holder or beneficiary of the domestic pass through entity. However, as provided in paragraph (c)(2)(iv) of this section (relating to a transfer to a domestic pass through entity of stock subject to a section 1295 election), a shareholder that transfers stock subject to a section 1295 election to a pass through entity will continue to be subject to the section 1295 election with respect to the stock indirectly owned through the pass through entity and any other stock of that PFIC owned by the shareholder.

(ii) *Limitation on application of pass through entity's section 1295 election.* Except as provided in paragraph (c)(2)(iv) of this section, a section 1295 election made by a domestic pass through entity does not apply to other stock of the PFIC held directly or indirectly by the interest holder or beneficiary.

(iii) *Effect of partnership termination on section 1295 election.* Termination of a section 1295 election made by a domestic partnership by reason of the termination of the partnership under section 708(b) will not terminate the section 1295 election with respect to partners of the terminated partnership that are partners of the new partnership. Except as otherwise provided, the stock of the PFIC of which the new partners are indirect shareholders will be treated as stock of a QEF only if the new domestic partnership makes a section 1295 election with respect to that stock.

(iv) *Characterization of stock held through a pass through entity.* Stock of a PFIC held through a pass through entity will be treated as stock of a pedigreed QEF with respect to an interest holder or beneficiary only if—

(A) In the case of PFIC stock acquired (other than in a transaction in which gain is not recognized pursuant to regulations under section 1291(f)